DOW THEORY LETTERS INC.

RICHARD RUSSELL
P.O. Box 1759
La Jolla, Calif. 92037

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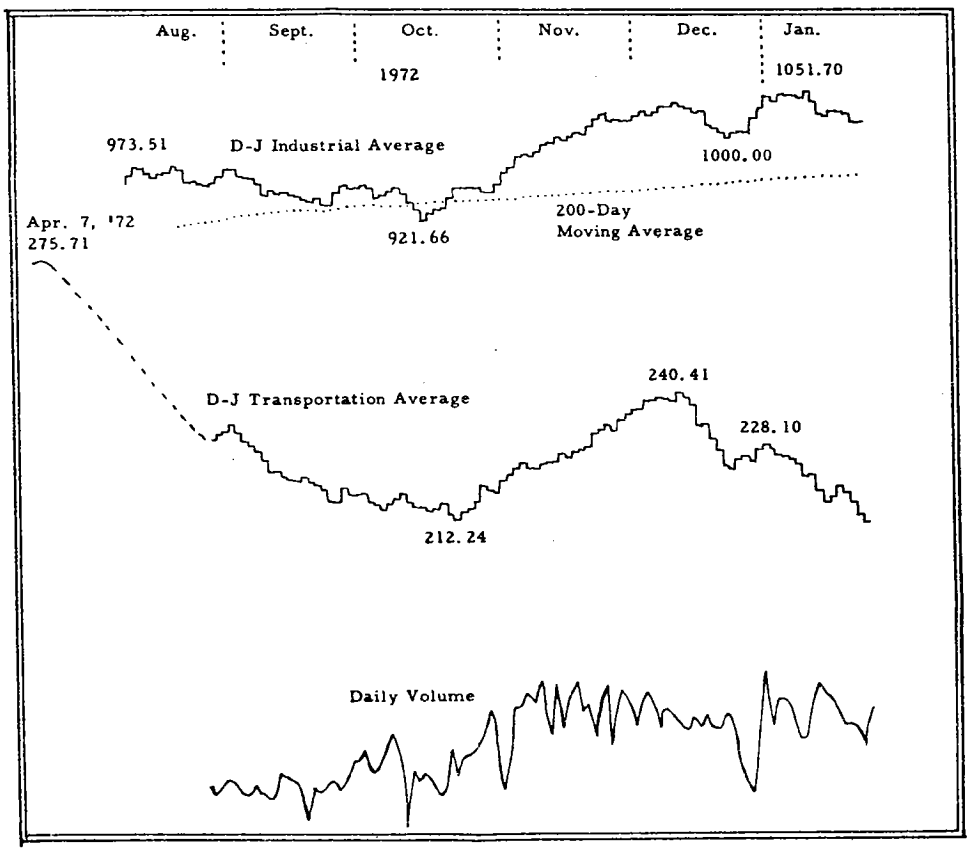
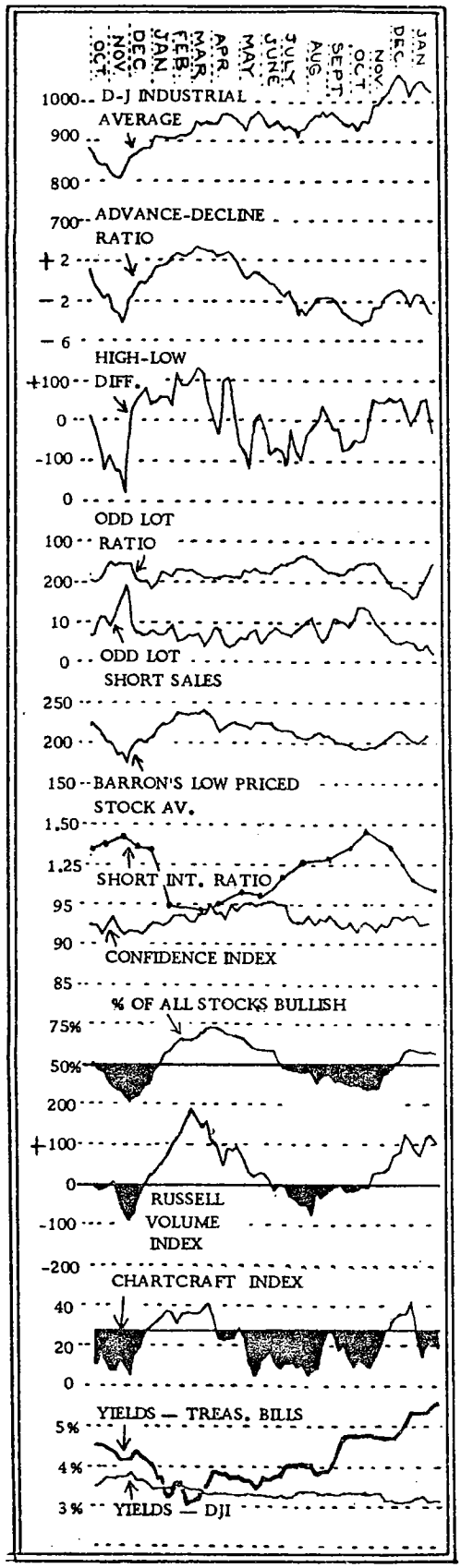
THE MARKET: Now that 32 million people are in the market, nothing's easy. There was a time when the primary bull trend bailed most investors' out of their mistakes. They would buy ten stocks, two would go down, three would move sideways and five would go up — and on balance they would be well ahead. That kind of arithmetic doesn't work anymore. Now the person with ten stocks finds that three are higher, three are moving sideways and four are sliding. That means that he is under water and praying for the arrival of the "big bull market" that everyone is promising him. On the first major decline, eight out of his ten stocks are liable to be under his purchase price, and he starts "mumbling" about the thieves of Wall Street.

A recent study of mutual funds shows that the longer the holding period for a fund, the more likely the owner will be to sell the fund. In other words, the group which has held its funds 10 years would be redeeming at a greater rate than the group which has held its funds five years, and the five year holders will be more likely to sell their funds than the two and three year holders. My conclusion is that the holders of funds are tending to become disillusioned, and the longer they wait, the more disillusioned they become.

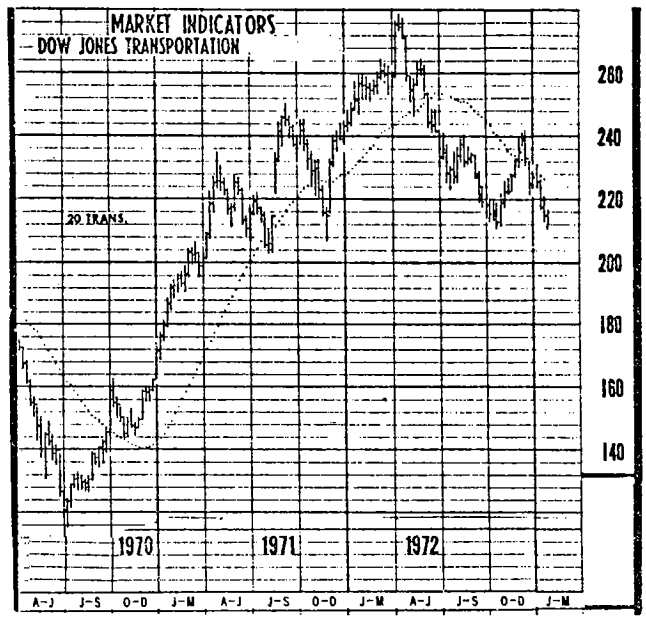
Suddenly, the bond funds have become wildly popular (see Letter 543), and the reason is simple enough. Bond funds (which have a good degree of safety) deliver immediately, and what they deliver is yield, or a return on your money. The average investor is sick of waiting for capital gains and appreciation which all too often never come. With bond funds he gets an immediate return, no promises or dashed hopes or sweat. Wall Street, always sensitive to what it can sell, is forming bond funds as fast as it can dream them up, and the public is happy with them since most pay 6% to 7% plus possible capital gains.





Actually, the Street has always been pretty good at giving the public what it wants. The problem is that on occasion Wall Street is capable of delivering to the public something it doesn't want, such as a collapse in market breadth, or a general bear market.

I have been warning, in recent Letters, that the Transportations Average is giving the lie to the advance in the Industrials. One of the stipulations of Dow Theory is that you cannot have a healthy industrial sector and a sick transportation sector, nor can you have a healthy transportation sector and a sick industrial complex. The rationale is simple enough. Industrials represent manufacturing capabilities and Transports represent sales capabilities. You have to ship what you make and vice versa, so both shipping and manufacturing are heavily dependent on each other. Thus, the thesis that Industrials and Transports must confirm each other in the price movement.



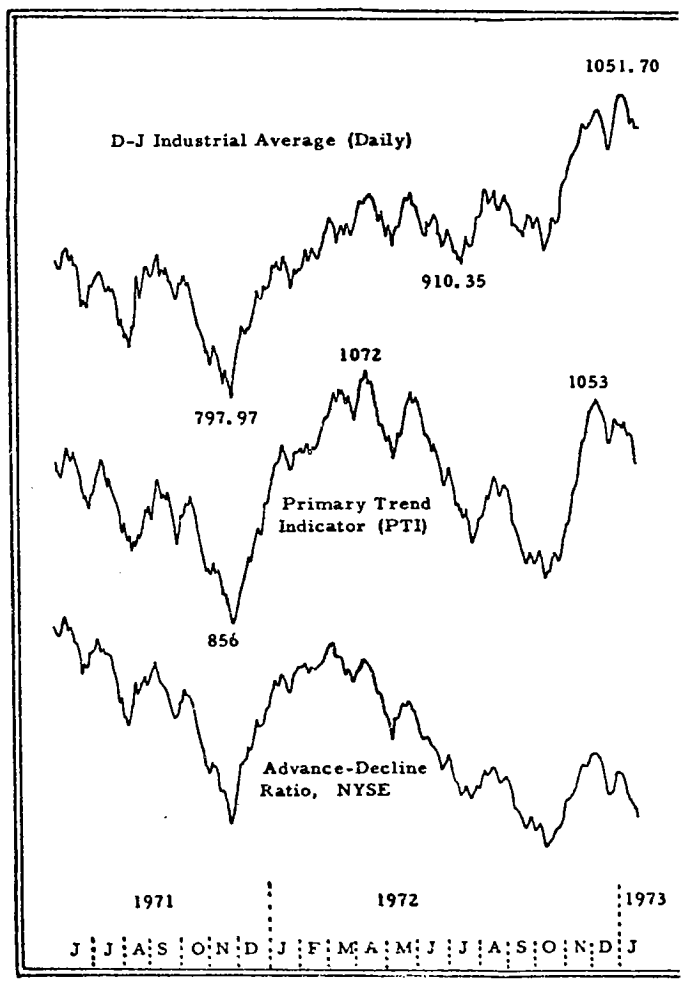
And that's where the trouble shows in the market. Note on the page 1 chart that on the October to December rally, the Industrials pushed through to a record closing high of 1051.70. But Transports refused by a wide margin to confirm, halting their climb at 240.41, this meant that Transports failed to regain even half of their April to October, 1972, losses, an ominous technical indication.

Following the December 11 peak of 240.41, Transports turned down, and from then on they actually parted directions with Industrials (divergence). This, as I explained in subsequent Letters, constituted a clear "danger situation." The first day of 1973 saw Transports close at a weak rally peak of 228.10, a level which has so far proved to be the Transport high for the year (see page 1 chart). A few days later, as Industrials posted their 1051.70 all-time high, Transports were already sliding off. This outstandingly poor performance on the part of Transports proved to be too much for the Industrial Average. The next day (despite the impending Vietnam peace agreement, which is now a fact, but a thoroughly discounted fact) the Industrials headed down.

One of the extraordinary aspects of the current situation is the massive "head-and-shoulders" pattern which has now developed in the Transports, a pattern so large that it has been totally missed or overlooked by Wall Street analysts (I have not seen a single word written about this). At any rate, I include a portion of the Trendline chart (345 Hudson St., NYC 10014) which shows the Transportation Average on a weekly basis for the period of 1970 to date.

On Monday, January 22, the Transports continued their remarkable weakness and actually violated their 1972 low of 212.24, thereby closing at their lowest level since September, 1971. This represented the first step in smashing any significant downside support in the carrier Average. Actually, a total crumbling of the structure shown on the chart would entail a drop below the 200 level, and such a violation would represent a penetration of all decline lows back to first quarter, 1971.

I take the January 22 violation of the 1972 Transport low as very negative. A further drop in Transports below 200 should be accepted as ominously bearish. Such a break would indicate a breakdown of the entire structure and would suggest a total collapse of speculative interest in the market. I say this because Transports represent the highly leveraged or speculative sector of the market, and the Transportation Average is certainly the most speculative of all the Averages.



Next, turn to the page 2 daily chart of the Dow Industrials and two of the indicators which we follow most closely, the PTI and the A-D ratio. The PTI is a composite of eight critical technical indices and measures market technical strength. The A-D ratio gauges the advancing or declining tendencies of all NYSE issues.

Note that on a longer term basis, the PTI failed to confirm the October to December advance in the Dow. For although the Dow shot up to new all-time highs in December, the PTI at 1053 could not better its own 1972 peak of 1072. Then, on a short term basis, the PTI again failed. For on the January, 1973, run-up the Dow pushed to another record peak (1051.70), but here the PTI could not even better its December high. This double non-confirmation proved too much for the market, and the decline was underway.

Finally, the A-D ratio for the NYSE continues to trace out a discouraging picture. The ratio has formed a downward zig-zag over the past few months, and the testing of the 1972 low is a distinct but depressing possibility. A breaking of the 1972 low would bring out a mass of daily new lows on the NYSE. The reason is that a new low on the A-D ratio would indicate that the majority of stocks are nearing their 1972-73 lows, with an increasing number breaking those lows.

For many months I have been warning of the possibility of an interest rate "crunch." The bond market is now looking green around the gills with many issues sagging badly. Last week leading banks boosted the prime rate to 6.25%, while overseas Italy instituted a two-tier money system. On January 22 Switzerland floated their franc as the dollar sagged.

The bellwether US 91-day Treasury bills have moved to 5.6% yield and 12 out of the 21 listed US Treasury bonds now provide yields of 6.10% or better. Foreigners are selling US Treasury bills, thereby putting pressure on short-term interest rates here. Meanwhile, interest rates in Europe (already high) are heading higher. All these are the "benefits" of rampant, unbridled inflation. The story is just beginning to be told in the markets, where speculative interest is switching from stocks to commodities ("where the action is") or to bonds ("where the income is").

I do not pooh-pooh the Vietnam peace, but I put it where it belongs as market news — at the end of this section. The market discounted the termination of the war weeks or months ago, and the peace news ends the war as a market influence. There is an old adage that "news goes with the trend." The war's ending catches the market with all my technical data decidedly weak.

The war's beginning and expansion was a tragedy, its ending a blessing. It was the longest war in our history and for stupidity, deceit, miscalculations, cruelty, costliness, pain, horror, almost no other event in US history can compare with it.

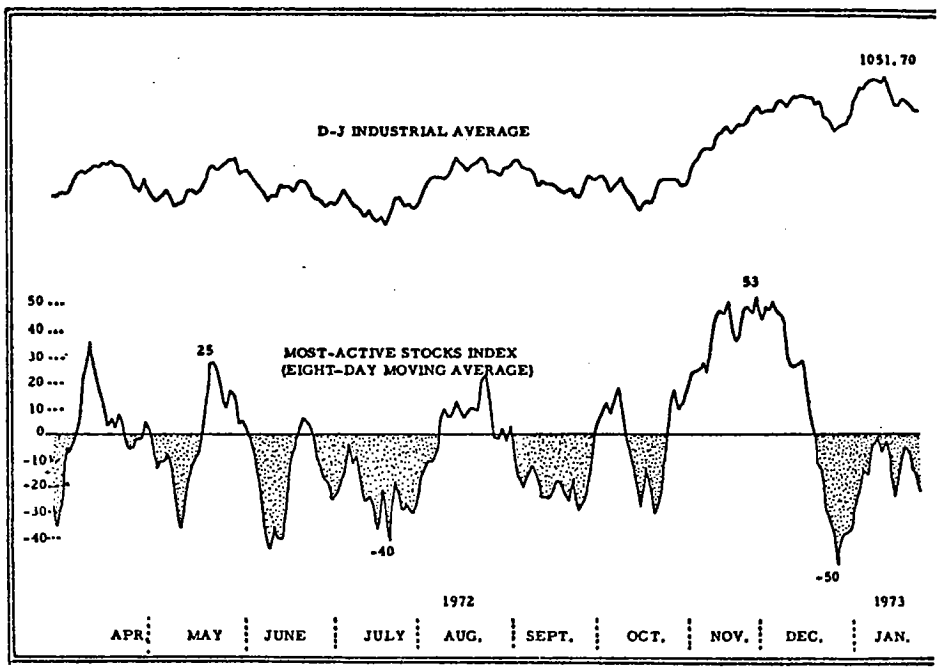
TECHNICAL STUDIES: There are many technical approaches to the market, few of them really understood. For instance, there are the so-called "trend following" approaches, and many financial writers have recently grown derisive of this approach. "They only tell us where we've been," is the objection. My answer is, if the average market practitioner even knew where he had been he would be ahead of the game. Of course, this is not the true answer. The answer is that in the stock market (as in many other places), a trend is conceded to remain in effect until proved otherwise. For instance, we can say that it is safe to bet that inflation will continue until proved otherwise. Or, Mr. Nixon will have disastrous relations with the press until that trend is proved otherwise. Seen from this standpoint, the trend continuation makes much sense. A market trend is always conceded to remain in effect until proved otherwise.

You can suspect that the trend is changing, you can hope it is changing, but be careful, trends seldom change as often as people think they do. The real problem is identifying the major underlying trend. Often it is obscure or deceptive. That may sound ridiculous but it is not. For instance, what has been the underlying trend of the market since 1966? Many claim that it has remained bullish. If so, why has the Utility Average never bettered its 1965 peak, why has the Transportation Average failed to better its 1969 peak, why has the advance-decline ratio been in a downtrend throughout the period, etc.? In other words, the picture since 1966 has been anything but decisive and clear.

Another technical approach is the "psychological" one. This seeks to determine the "thinking" or "feeling" behind the market. Here we can use odd-lots because we know that the odd-lot public usually is doing the opposite of what the informed money is doing (and of course, what we are really interested in is not the odd-lotter but his opposite, the informed investor). We can use the short interest indicators, contrary opinion, and a number of other "gauges" of market sentiment. If we can know the long-term sentiment of big money, we are way ahead in the market business.

A third technical approach is the "character of the market" method. Here we seek to examine the character or the quality of each movement in the market. If, for instance, the Dow goes up but a majority of issues are declining, we say the character of the advance is poor. If new highs drop off during an advance in the Dow, we say that the market character is

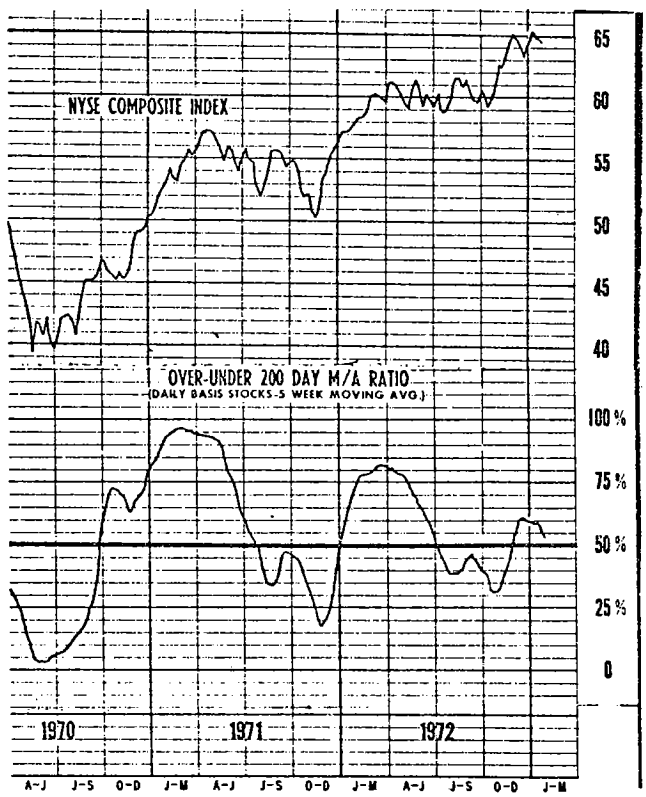
deteriorating. If volume is petering out on an advance, we are again disturbed by the character of the market. In most character-of-the-market analysis, divergence plays an important part. And in most divergent analysis, the Dow Industrials are used as the standard. The Dow represents quality (informed) leadership, and we are always interested in what the rest of the indices do when the Dow advances or falls.



Of course, this method represents the basic or original approach to technical analysis. The Dow Theory states that two Averages, Industrials and Transports, must confirm each other by rallying or declining through preceding points. Thus, the Dow Theory is the father of the character of the market approach and the first and still (in my opinion) most important segment of divergence-analysis.

I am going to examine two characters of the market gauges, both of which have appeared here before. The first is the daily plurality index of the "15 most active stocks" on the NYSE. The most-active stocks (listed each day in most newspapers) comprise roughly 20% to 30% of each day's volume. The trend in the most active stocks has a tendency to set the trend for the entire market. When the Dow is going one way and the plurality index of the most active stocks is going another, I consider it an important divergence.

The most-active index is tabulated by taking the daily pluralities and putting them on an 8-day moving average. For instance, if on a given day five stocks advanced, four declined and six were unchanged, the plurality would be plus one. The last eight days' pluralities are added up, and the resultant figure is the index figure for that day.



The chart shows a very interesting picture. Note that in April of last year the index tended to stay below zero, suggesting distribution. During this time the Dow was generally moving sideways while the advance-decline ratio and most stocks were sliding. Then during November and early December the index did produce a good upside bulge, touching a peak of plus 53 on November 24. From that point on, the index began receding. The Dow slid off during late December, hitting a low on December 21 (on that day the index struck a low of minus 50). Next came the explosive rally which took the Dow to the January 11 all-time high of 1051.70. But here the index began "talking." The index struck a 1973 peak of only zero, receded to minus 3 on January 11 (the day the Dow hit its high). Two days later, on January 15, the index had plunged to minus 23 as the Dow tumbled a startling 27 points in 3 days.

Conclusion: The index showed distribution all during 1972. It showed strength during November and early December, but it gave the lie to the explosive December-January rally in the Dow. In fact, the December-January rally in the Dow could not even take the index above zero, the worst performance on this index in years.

A second character of the market method is published by Trendline. This is the ratio of the NYSE stocks holding above or below their 200-day moving average lines. In action, this index corresponds very closely to the index which I have often

included here, the number of NYSE issues in bullish trends. Both of these studies are now saying the same thing, but I am including the Trendline study because it has not been shown here before.

Note on the page 4 chart that the ratio of stocks holding above their 200-day MA has declined with each successive advance in the NYSE Composite Index. The 1970-71 advance took the ratio to over 90%, the 1971-72 advance saw the ratio climb to 82%, the latest 1972-73 rise saw the ratio barely able to climb over 60%. Thus, despite new highs in the leading averages, the number of stocks able to climb above their own moving averages has contracted steadily.

In character of the market analysis, one works with divergence and probabilities. For instance, regarding the 200-day MA study, one must say that the number of stocks moving above their MA has steadily diverged with the trend of the popular averages. When this occurs, probabilities suggest that (1) either the 200-day index must improve, or (2) the averages will tumble, thereby getting back "in gear" with the MA studies. With each rise since 1970, the divergence has appeared. As a rule, the more flagrant and extended a divergence, the greater the ultimate "getting together" of the entire market. If the averages are to get together with the 200-day MA indicator, we can expect a major and extended slide in the period ahead. Note also that this is the third peak in the 200-day MA index. Three movements often constitute the completion of a major trend in the stock market, so that we might expect a major decline to start here in 1973.

DIARY: I just saw the movies, "Fat City" and "Play It As It Lays." The theme of both was "nothing makes any sense, there is no hope, life is meaningless." A hundred or even fifty years ago Americans were fighting the simple struggle to survive, to get their "three square meals a day," to raise a family or make "a decent living." Today, I believe the majority of people are no longer in this struggle. Certainly those under thirty are not struggling simply to survive.

With the five day week (often shorter), with more leisure time than ever, with welfare, with jobs available everywhere, with menial jobs going begging, the great fight is one of the soul. In some ways, "Play It As It Lays" was one of the most depressing movies I have seen in years ("The Last Picture Show" comes a close second), because in each case the theme is the meaninglessness, the hopelessness of life.

I suppose I identify with these three movies, and that is why I found them so depressing. For the first two-thirds of my own life I was so busy trying to "beat the world" that I never had time to consider whether life had any real meaning or not. I never even got to the question, much less formed an opinion. I consider this question one of the prime questions of our existence. Oscar Wilde once said that a cynic is one who knows the price of everything and the value of nothing. I would say that a soul in hell is one who knows the advantages and disadvantages of everything and the meaning of nothing.

To digress a minute, subscribers seem to like it when I write about California. Those who don't live here like to read about it, and those who do live here like to read about it even more. California is the land of lost souls, the place where you can stay warm until you find out whether you want to live or die. California has a million faddists, all freaking out in different ways while they search (often without realizing it) for a meaning in life. Some of them run around the state in campers, some own hamburger franchises, others go out into the desert to look for rocks, while still others join satanic societies or disappear into one of the dozens of anonymous beach colonies.

One thing I find outstanding about California is that the state is heavily populated with good book stores as well as palm trees and health nuts. One day I walked into one of those stores and leafed through a book written by a psychiatrist who had survived World War II and Auschwitz. The book was titled "Man's Search for Meaning," and it was written by Dr. Victor Frankl, who, I understand, now teaches in San Diego (Dr. Frankl, if you happen to read this I'd like to meet you). That little paper book changed my thinking and my life. I wonder how Dr. Frankl survived Auschwitz; I wonder why he lives in San Diego; I wonder why he was kind enough to write a book? To tell the truth, I spend alot of time feeling wondrous — and just wondering...

FROM OUR "WHERE WILL IT END?" DEPT.: Last year the Defense Dept. went to Congress and got a $100 million loan for Lockheed in order to keep the company afloat. This year the Navy went further, actually made a direct $18 million loan to Grumman, this following two other Navy loans to Grumman totaling $36 million. The loans came following Grumman's refusal to build more F-14 fighters, on the ground that it was losing $2 million per plane. And most recently, the Navy has bought $1.7 million in the stock of Gap Instrument Corp., a supplier which was on the edge of bankruptcy. Next...

COMMENT: It has been said that California is like the US but more so. I have often thought that San Diego is typical of California only more so. At any rate, perhaps this clip from our local paper (page 6) is the year's most penetrating commentary

of our times. Here is a man reduced to being on welfare, he is going mad because the Post Office is now almost incapable of delivering a letter on time, in other words, this man is utterly dependent on the Government. So what does he do, he resorts to the "language" of our time, violence (violence is the ultimate expression of impotence, wrote the great psychiatrist, Frederick Perls). So here we have it, big government, poverty and welfare, inefficiency in government, despair, violence, and an attack on a member of a racial minority. It all happened in San Diego...

MAN DENIES POSTAL ROW

A San Diego resident was arraigned in U.S. District Court yesterday on charges of attacking a postman because his welfare check was late.

Woodrow McCoy, 57, of 324 24th St., was released on $2,500 bail after pleading innocent to charges of attacking Rogelio Rintacutan, a U.S. Postal Service letter carrier.

STOCKS: I am including my own technical charts of two stocks which provide a rather striking contrast in this market. General Motors is perhaps the outstanding bellwether stock of the market. On my technical rating scale, GM has dropped from a November high of 4 to last week's figure of 1 (only the odd-lot ratio index is strong). Over the past two weeks, GM has penetrated its 10-week moving average and is now one of the weaker Dow stocks.

The second chart is a daily (GM was weekly) chart of Campbell Red Lake, Canada's leading gold mine but listed on the NYSE. Here we see that CRK has put on an outstanding performance since October and all the technical indicators are bullish. With profits rising sharply, CRK recently raised the quarterly dividend from 11.5¢ to 22.5¢. On the point & figure chart (courtesy of Chartcraft, Larchmont, NY 10538) CRK has broken out of its recent consolidation pattern and must go to 45 for an "all clear" upside signal.

This week I count 10 Dow stocks with strong technical counts of 4, 5 or 6, and 9 Dow stocks with weak counts of zero or 1. This is the lowest number of strong stocks and the highest number of weak stocks since early November.

Critical point to watch on the Dow (see page 1): The December 20 low of 1000.00.